III. OVERALL STATUS AND OUTLOOK

As perhaps some of you may be aware, the key characteristic of the plan for 1984 was a budget unusually skewed toward the second half. Through the first six months we were, with the exception of U.S. and International Services, performing to plan. Those deviations, while important, still left us in a position to meet the plan for the year, depending, as I say, on how the second half unfolded. Over the course of July and August it has become clear that the planned second half improvement in the systems and systems-related part of our hardware business and in Commercial Credit will develop but it will not do so in Peripheral Products. In fact, the past two months have seen the outlook for two parts of the peripherals business deteriorate significantly. In addition, the degree of second half improvement U.S. and International Services will be somewhat less than what we expected. As a result, it is now clear that 1984 will not meet our original expectations.

By far the largest impact is in the peripherals area so let me cover that first.

The single, largest loss in the computer business in the 1984 budget was the IBM plug compatible peripherals business. We have always viewed the plug business as incremental
strategically to the basic OEM business. As such, it brought additional manufacturing volume at modest incremental expense. It also provided a base and an entree into a profitable, third party maintenance business. Without going into a lot of technical detail, with the 33800, it wasn't really possible to maintain an incremental approach. For example, the technical expense alone of the current 33800 program is $45 million. The market risk is also high with IBM having been out with their product so far ahead of others.

Events of the past two months have not helped the situation. In July and August we began to experience problems with our installed units that resulted in head crashes at an increasing rate. The severity of this problem has led us to sharply curtail production and customer deliveries for a short time while we sort out the problems. Even so, this will serve to reduce the total shipments and PSG's revenue for the year, and will also generate negative manufacturing variances within MPI. The result will be a loss in PSG even larger than budget.

The Peripheral Products plan for 1984 depended, in addition to a second half turnaround in the plug business, on the microcomputer market for floppy disk drives. We went into 1984 with an order in-house for 400,000 units from IBM at a price of $148. In February, IBM began discussions about an additional
300,000 units for delivery this year. But actually at about that point the market for floppies began to change dramatically with new products and market entries announced by 26 Japanese competitors -- all attempting to gain market share at the expense of the three principal U.S. suppliers -- Tandon, Shugart, and Control Data.

The majority of these Japanese products were technically sound, and thus, price became the only differential. For example, IBM has qualified a number of additional suppliers who are proposing to sell the same full-height floppy for $78 in reasonable volume purchases. Obviously, such a price is well below our actual current manufacturing cost.

To counter this price erosion, we began an aggressive program to subcontract manufacturing to off-shore suppliers in Taiwan and Hong Kong. This approach will enable us to retain some portion of our customer base at break-even to nominal profit levels -- but the adverse impact of these events on our 1984 results cannot be avoided.

On a more positive note (and there are some), orders and revenues for mature disk products continue at well above budgeted levels -- and production levels for new OEM disk products that were introduced in 1983 are increasing at a rapid rate. This is particularly true for the XMD, FSD, and 5 1/4" Wren disk drives.
Thus, in spite of the problems, the OEM product line, ranging from an OEM version of the 33800 drive down to the 5 1/4" Wren, appears to be well positioned for strong market performance and profitable business growth. The same can be said for the OEM tape drive business. We currently expect to double production levels in 1984 and expect a major turnaround for Valley Forge (where our tape drives are designed and produced). From a loss in 1983, to a profit this year.

In summary, these OEM disk and tape products and the newly announced optical disk products from the Phillips partnership, provide a broad range of storage products to meet the demands of the OEM market.

IV. **MARKET RESTRUCTURING**

All of this is but one more instance of the enormous market restructuring that is going on in every aspect of the computer industry. The peripherals business is now truly a pure commodity market at the low end of the line and this will spread over a relatively short period of time up through the higher end -- that is higher technology products. The Japanese factor is truly at work here as is the increasing dominance that IBM is gaining in mainframe computers and with it their ability to control the plug compatible peripheral makers. For
example, look what one of them -- STC -- is going through. In essence, they have run out of strategic options. Their 3380 program has experienced the same too little, too late problem ours has. A couple years ago they started a foray into the plug compatible computer mainframe market which ended in failure (and limited partner lawsuits) earlier this year. A recent article which was intended to give an optimistic look at STC inadvertently actually highlighted its strategic dilemma by pointing out that its future growth, because of the mainframe failure and the 3380 problems, rested on one more attempt at a new technology -- the optical disk product. (That's an interesting arena all right -- but as a volume replacement for the basic disk business, it has a long way to go.) **Trilogy is an even sadder story.** The only plug compatible mainframe manufacturers today are the Japanese (counting Amdahl as a U.S. based Japanese manufacturer). That fact, likewise, reduces the available plug compatible peripherals market. The fact is that with peripherals a technology factor alone can no longer assure survival in the face of Japanese and IBM economies of scale.

Fortunately, we have achieved a volume of peripherals business which allows us to compete in this market if we learn commodity level manufacturing techniques rapidly enough. Needless to say, this is a matter of top priority for management of Peripheral Products Company and the products group.
But there is as a consequence of such restructuring as is going on in the peripherals market -- an enormous short-term pressure on profits. In that regard, I want to make sure I don't miscommunicate. Even with all the problems, the peripherals business will be profitable this year and is reacting aggressively and well to its challenges.

Having mentioned the subject of market restructuring and the peripherals business, let me elaborate on the general situation in our industry for a moment. I already mentioned IBM compatible mainframe computers and peripherals. Take micros. Here's an excerpt from the Wall Street Journal last week with regard to Hewlett-Packard: "Spectrum is the code name for a project to develop, according to the company, a 'breakthrough' computer technology. The project was announced at a securities analysts meeting last January, but the company hasn't disclosed when it might unveil the new technology....the problem with a 1986 rollout of Spectrum products, according to both Mr. Kurlak and Ms. Muratore, is that the delay, if it is one, will increase pressure on the company's margins....like Digital Equipment, Ms. Muratore notes, Hewlett-Packard needs a high-margin product line such as Spectrum to improve its profitability. The HP 3000, the company's existing line, is a mature product that the company is under increasing pressure to discount in order to maintain sales, she and some other analysts assert. 'You have a company that's struggling at the end of a product cycle.'"
Digital Equipment Is Giving Up Fight For Personal-Computer Retail Market

BY WILLIAM M. BULKELEY
Staff Reporter of The Wall Street Journal

MAYNARD, Mass.—Digital Equipment Corp., which entered the personal-computer market almost two years ago, is ready to admit it has failed in the retail market.

It failed largely because its products are more expensive than many competing computers and aren't compatible with International Business Machines Corp.'s personal computers.

At a news conference today to introduce a lower-priced version of the Decmate, one of its four personal-computer models, Digital executives will outline a marketing strategy that treats personal computers primarily as part of companywide computer networks rather than as free-standing products sold on their own merit.

Digital decided to go after the business market with its personal computers partly because it failed to grab much market share selling through retail computer stores where most personal computers are sold. "The thrust into the pure retail channel didn't work that well for us," said Ward Mackenzie, vice president, business products.

This year it became clear that Digital couldn't compete head to head with IBM, said many dealers who dropped Digital products. Oakland, Calif.-based Computerland, the largest U.S. retail computer chain, ended its bulk-purchase plan with Digital earlier this year because volume was too small. "DEC has a great box; but it wasn't IBM compatible," said Charles G. Kinch, a vice president for the chain. He noted that, except for Apple Computer Inc. products, business computers don't sell well unless they run the same programs as IBM personal computers.

Digital says about 500 retail stores still carry its products, down from a peak of more than 900. However, Mr. Mackenzie said only about 200 are significant dealers.

"It's a sad story. They're very nice machines but DEC hasn't responded to price cuts by everyone else," said Lee Adler, computer manager at the Boston University bookstore, which is clearing out its inventory of Digital computers. Digital's $3,570, almost $1,000 more than a comparable IBM personal computer. Digital didn't match price cuts by IBM earlier this year.

Despite such marketing strengths as the company's size and resources, Digital's lack of IBM compatibility is likely to be a problem in selling its personal-computer models even to large companies, analysts say. "In large corporations, IBM PCs have become the personal workstation of choice," said Craig Symons of Gartner Group, Stamford, Conn. While Digital boasts that many software programs have been rewritten for its personal computers, others remain unavailable.

One Digital executive said the company currently is debating whether to design an option that would let Digital personal computers run IBM programs.

Digital, whose computer sales volume is second only to IBM, said it will concentrate on selling its personal-computer lines directly to large companies and to small businesses through third parties and its own sales force.

Mr. Mackenzie, the third DEC vice president in two years to take charge of retail store sales, said that Digital's remaining retail sales primarily will be handled by stores that target specific types of customers such as lawyers or accountants.

Mr. Symons estimated that in fiscal 1984, ended June 30, Digital sold about 125,000 personal computers valued at $410 million, or about 7.3% of the company's total revenue. Insiders say the line was barely profitable. "It makes good sense to get out of the retail market. They don't have the expertise there," said Mr. Symons.

Decmates are mostly used for word processing and as computer terminals linked to larger DEC computers. Digital said the new model, which distributors say will cost under $2,800, will be attractive to companies replacing secretary's typewriters with communicating word processors, Digital predicted.

Most of the large computer companies that entered the personal-computer market after IBM announced in August 1981 that it was entering the market have found scant success at the retail level. Future Computing Inc., a Richardson, Texas, market research concern, said only IBM, Apple, and Compaq Computer Corp. each have grabbed more than 10% of the retail market.

Computer companies such as Wang Laboratories Inc., Burroughs Corp., NCR Corp., Data General Corp. and Hewlett-Packard Inc., all have had disappointing retail results.

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WALL STREET JOURNAL OCTOBER 1, 1984

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Trilogy Ltd. Is Sued By Holders Who Assert Concern Mislead Them

BY WALL STREET JOURNAL Staff Reporter

CUPERTINO, Calif.—Trilogy Ltd. said it was sued by shareholders who claimed the semiconductor concern and some of its directors violated U.S. securities laws related to its initial public offering in November 1983.

The complaint was filed in U.S. district court by Irwin Clofine, who said he bought 300 shares of Trilogy common stock in November 1983 at $12 a share. Mr. Clofine, a Pennsylvania resident, sued on behalf of himself and other Trilogy shareholders who were allegedly misled by Trilogy's officers, including Gene Amldahl, the company's founder, chairman and chief executive.

Also named in the lawsuit was Merrill Lynch, Pierce, Fenner and Smith Inc., the lead underwriter of Trilogy's initial public offering of approximately five million shares.

The lawsuit claims that Trilogy repeatedly issued false and misleading statements about the development of its "superchip" technology, which was to have helped launch the company's large-scale computers. Trilogy suspended development of that project in August and said it would concentrate on more conventional semiconductor technology.

Trilogy said the complaint "is without merit" and said the company intends to "vigorously defend it" against the lawsuit.
And even IBM is adapting to a changing world -- here's a quote from a recent Business Week: "The party followed a venerable Texas formula: beer, barbecue, and country-and-western music. Big Blue used magicians and comedians to help sell its new Personal Computer AT. 'Thomas Watson would have rolled over in his grave to see alcohol served at an IBM function,' marveled a former IBMer."

Apple? Again, here's what Business Week said recently. "Apple Computer, one of Wall Street's hottest performers in recent years, has been frozen out of August's blistering market....Analysts expect the stock, which reached its record high of 63 1/4 in June, 1983, to stay in the summer's trading range of 24 to 30. Only sheer faith is holding up the stock to where it is now....McKay notes that Apple is 'extremely well managed and has excellent manufacturing and marketing capabilities and great products.' But the industry's proliferation of new products, he warns, is certain to bring increased pressure. The business, notes Newman, is 'at the maximum stress point in terms of an industry consolidation.'"

What about the traditional mainframe part of the industry? The restructuring there, of course, has been going on for much longer. The fact is that the only U.S. mainframe manufacturers in existence today -- other than Control Data -- required an older established business to sustain them in the computer business: NCR, Sperry, Burroughs, and Honeywell.
What all this represents is an industry which is moving at an incredibly rapid pace from one in which technology is everything -- to one in which while technology is both necessary and increasingly expensive and simultaneously more widely available, it is not at all sufficient. "Value added" and "market focus" are the key words as our industry goes into the second half of the 80's.

What it nets down to is this: As technology becomes more widely available and technological advantage more elusive, the frantic scramble for strategic options becomes more and more desperate. Ultimately, all except IBM and the Japanese are led to either demise -- we counted up the other day in the Management Committee meeting and at least six micro manufacturers have gone under this year -- or a strategy based on the premise of market focused value added. In that sense, Control Data is as well positioned as possible for we started such an approach 20 years ago. I think the bad news may be that because we were so far ahead of others in our services strategy that we became too complacent and this has led to the sluggishness of our response, for example in Cybernet and BIS, to the demands -- and for that matter the opportunity -- presented by distributed computing.

Finally, I hardly need elaborate on the restructuring in the financial services market -- you can hardly pick up a paper or a business publication without a headline jumping out at you in that regard. [SHOW BUSINESS WEEK COVER]
In any event, as difficult as the outlook is for 1984, the organization is continuing to respond strongly as it has over the past 2 1/2 years. Employment has been reduced 3,600 since two years ago and some 2,014 just in the last year. We have shut down or spun out 14 businesses in the last year and we are continuing to analyze our operational effectiveness in all respects.

So as I've said, while we've known happier earnings times, there is no absence of resolve or aggressiveness in attacking the problems, and because we have invested over the years and provided ourselves with strategic options, we are better positioned than most any of our competitors. As a result, the future, including 1985, looks better than ever.

V. EAS RESULTS

Another aspect of the change and restructuring occurring in our markets and in the company is the effect it has on employee attitudes. In that regard, to give everyone a chance to participate, we decided this year to actually take a census rather than the statistical sample approach to the employee attitude survey.

I'll cover a few highlights of that survey. Not surprisingly, overall the survey shows there has been some decline in
IMPROVEMENT IN THE PAST TWO MONTHS WITH INCREASED SHIPMENTS OF CD 110'S AND ZENITH 150 MICRO PLATO SYSTEMS. BUT WE ARE BEHIND SCHEDULE AND WILL NOT MAKE OUR AGGRESSIVE REVENUE AND PROFIT GOALS FOR THE SECOND HALF. THE TOTAL NUMBER OF CBE UNITS EXPECTED TO BE SHIPPED INCLUDE 1,160 CD 110'S AND 1,150 ZENITH MICROS. ALL OF THE ZENITH SHIPMENTS WILL OCCUR IN THE SECOND HALF.

WE STILL EXPECT TO TURN THE CORNER ON ALL THE SERVICES BUSINESSES IN THE FOURTH QUARTER AND ACCORDINGLY BE IN A GOOD POSITION TO BE PROFITABLE IN INTERNATIONAL SERVICES IN 1985.

VII. COMMERCIAL CREDIT

CCC'S ACTIONS TO REDUCE THE OPERATING COSTS, TAKE BETTER ADVANTAGE OF THE EXPERTISE AND DISTRIBUTION NETWORKS WHICH ARE IN PLACE, AND ADDRESS THE PRODUCT OFFERINGS, HAS IMPROVED ITS
POSITION STEADILY OVER THE COURSE OF THIS YEAR. ALTHOUGH THE
RESULTS OF THESE PROGRAMS ARE BEGINNING TO PAY OFF, OBVIOUSLY
THE FULL IMPACT WON'T BE FELT IN 1984.

COMMERCIAL REAL ESTATE LENDING IS AN EXAMPLE OF THE TYPES OF
PROBLEMS WHICH HAVE BEEN ADDRESSED. BECAUSE OF CCC'S SHORT
TERM VARIABLE RATE FUNDINGS, RELATIVELY LOW LEVERAGE AND LACK
OF SPECIFIC EXPERTISE IN COMMERCIAL REAL ESTATE, THEY DECIDED
TO DISCONTINUE PURSUING THIS MARKET WITH A STANDALONE PRODUCT
OFFERING. THEY CONCLUDED THAT THE RISK OF TAKING ADDITIONAL
FIXED RATE CONTRACTS, FUNDED WITH VARIABLE RATE DEBT, IN AN
INDUSTRY WHERE THEY DID NOT HAVE THE EXPERTISE TO PICK AN
MANAGE THE SPECIFIC PROJECTS, DID NOT OFFER THE TYPES OF
RETURNS REQUIRED.

IN OTHER AREAS, CCC MANAGEMENT IS DRIVING FOR INCREASED PROFIT
BY INCREASING VALUE ADDED SERVICES. THEY ARE AGGRESSIVELY
DRIVING FOR GROWTH IN CERTAIN TYPES OF FINANCIAL SERVICES WHERE STRAIGHT LENDING SERVICES CAN BE SUPPLEMENTED WITH THE VALUE ADDED SERVICES. THESE SERVICES ARE A KEY TO INCREASING THE PROFITABILITY. HERE ARE A FEW EXAMPLES:

0 FLEET AUTOMOBILE LEASING TO CORPORATE CLIENTS IS, AS YOU ARE AWARE, A GROWING BUSINESS FOR CCC. BUT THE FEES FROM AUTOMATED FLEET MANAGEMENT SYSTEMS ARE EQUALLY IMPORTANT AND ACTUALLY GROWING MORE RAPIDLY.

0 THE COMPANY OFFERS CORPORATE CLIENTS RELOCATION SERVICES FOR ITS EMPLOYEES. IN ADDITION TO EARNING A FEE FOR FINANCING THE HOMES, THEY EARN A FEE FOR MANAGING THE DISPOSITION OF THE REAL ESTATE.

0 IN THE RECEIVABLE FACTORING OPERATION THEY, OF COURSE, GENERATE FINANCE INCOME, BUT IN ADDITION ARE EARNING FEE INCOME FOR CREDIT MANAGEMENT AND COLLECTION ACTIVITY.
MOST OF THESE ARE NOT NEW PRODUCTS, BUT THEY ARE BEING GIVEN INCREASED EMPHASIS IN THE MARKETPLACE BECAUSE THEY CAN BE A COMPETITIVE MARKETING EDGE AND, MORE IMPORTANTLY, THEY INCREASE THE PROFITABILITY OVER A PURE FINANCE PRODUCT.

THE CCC MANAGEMENT IS CONTINUING ITS OBJECTIVE OF BECOMING A MUCH LEANER AND MORE PRODUCTIVE ORGANIZATION. THEY HAVE INITIATED A PROGRAM TO PUSH CERTAIN PRICING AND CREDIT AUTHORITY LOWER INTO THE ORGANIZATION. AS A RESULT: THEY HAVE BECOME MORE RESPONSIVE TO THE MARKET; THE YIELDS ON PERSONAL LOANS ARE INCREASING; AND THERE HAS BEEN A REDUCTION IN THE NUMBER OF STAFF PEOPLE AT THE REGION AND GROUP LEVELS.

THE EFFORTS TO LOOK FOR EFFICIENCY ARE PAYING OFF. THE CURRENT POPULATION OF CCC IS JUST UNDER 8,500 PEOPLE. THIS IS DOWN OVER 1,000 PEOPLE FROM 12 MONTHS AGO. AT THE SAME TIME, THE VOLUME AND QUALITY OF THE BUSINESS IS UP.
VII. CONCLUSION

OUR THREE-DAY MANAGEMENT COMMITTEE MEETING AT RED WING AT THE END OF JULY FOCUSED PRIMARILY ON WHAT ACTIONS ARE NECESSARY TO FINISH STRONG IN 1984 AND WHAT NEEDS TO BE DONE IN EACH OF THE BUSINESSES TO MAKE 1985 A MUCH STRONGER YEAR FINANCIALLY. PART OF OUR CONSIDERATION WAS TO DEVELOP THE DETAILS OF THE ORGANIZATION CHANGES THAT I MENTIONED TO YOU AT THE TOLEDO BOARD MEETING.